Legislative Audit Division

State of Montana

Report to the Legislature

November 1995

Financial-Compliance Audit

For the Fiscal Year Ended June 30, 1995

State Compensation Insurance Fund

Department of Administration

This report contains one recommendation related to recording financial activity.

Direct comments/inquiries to:
Legislative Audit Division
Room 135, State Capitol
PO Box 201705
Helena MT 59620-1705

95-5

FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations which could have a significant financial impact. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

The Single Audit Act of 1984 and OMB Circular A-128 require the auditor to issue certain financial, internal control, and compliance reports regarding the state's federal financial assistance programs, including all findings of noncompliance and questioned costs. This individual agency audit report is not intended to comply with the Single Audit Act of 1984 or OMB Circular A-128 and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the reporting requirements listed above. The Single Audit Report for the two fiscal years ended June 30, 1993 has been issued. Copies of the Single Audit Report can be obtained by contacting:

Legislative Audit Division
Room 135 State Capitol
PO Box 201705
Helena MT 59620-1705

Montana Legislative Branch

Legislative Audit Division
Scott A. Seacat, Legislative Auditor

November 1995

To the Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the State Compensation Insurance Fund, Department of Administration, for the fiscal year ended June 30, 1995. We performed this audit of the State Compensation Insurance Fund in compliance with section 39-71-2361, MCA. Included in this report is one recommendation related to compliance with state law.

We thank the State Fund president and his staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

Room 135, State Capitol Building PO Box 201705 Helena MT 59620-1705
Phone 406-444-3122 FAX 406-444-9784

Legislative Audit Division

Financial-Compliance Audit
For the Fiscal Year Ended June 30, 1995

State Compensation Insurance Fund

Department of Administration

Members of the audit staff involved in this audit were Brenda Bokovoy, Geralyn Hoffman, Lorry Parriman and Susan Schwend.

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State Compensation Insurance Fund Board of Directors and Executive Directors

Board Members		Term Expires
Rick Hill, Chairman	Helena	1997
Sandra D. Reiter	Billings	1997
James A. Brouelette	Stevensville	1997
Tom Horn	Cohagen	1999
Dale Mahlum	Missoula	1999

Carl Swanson, President

Mark Barry, Vice President, Administrative and Finance Department

Nancy Butler, Vice President, Legal

Tor Gudmundsen, Acting Vice President, Management Information System

Jim McCluskey, Vice President, Claim Department

Azmi Salaymeh, Vice President, Loss Control and Premium Audit Department

Joanne Shydian, Vice President, Human Resources

Larry Wiedey, Vice President, Underwriting

The listing below serves as a means of summarizing the recommendation contained in the report, State Compensation Insurance Fund's response thereto, and a reference to the supporting comments.

Recommendation #1	We recommend the State Fund record intrafund eliminations and classify expenditures on the accounting records in accordance with generally accepted accounting principles.	6
	Agency Response: Concur. See page B-3.	

Introduction

The State Compensation Insurance Fund (State Fund) was established by the 1989 Legislature to administer the state operated workers' compensation plan. The State Fund writes workers' compensation indemnity and medical insurance coverages under the mandatory workers' compensation system of the state of Montana.

The State Fund is a competitive fund but also serves as the insurer of last resort. Employers may obtain coverage through the State Fund, through other authorized insurance companies, or through a self funding plan. In 1995, approximately 25,600 employers were insured by the State Fund.

Under state law, the Governor appoints five board of directors to set policy for the State Fund and hire a president to manage State Fund operations. The State Fund is attached to the Department of Administration for administrative purposes only. At June 30, 1995, the State Fund had 268.75 authorized full-time equivalent (FTE) positions. The State Fund has 250.15 authorized FTE positions for fiscal year 1995-96 and anticipates 242 positions by June 30, 1996.

In accordance with section 39-71-2361, MCA, we performed a financial-compliance audit of the State Fund for the fiscal year ended June 30, 1995. The objectives of the audit were to:

1. Determine State Fund's compliance with applicable laws and regulations.

2. Make recommendations for improvements in the management and internal accounting controls of the State Fund.

3. Determine if the financial statements present fairly the financial position, results of operations, and cash flows of the State Fund for the fiscal year ended June 30, 1995.

4. Determine the implementation status of prior audit recommendations.

Areas of concern deemed not to have a significant effect on the successful operations of the State Fund are not specifically included in the report, but have been discussed with management.

Actuarial Soundness

Section 39-71-2352, MCA, separates funding sources for claims incurred before July 1, 1990 (Old Fund) and those incurred on or after July 1, 1990 (New Fund). Premium rates are set to cover actuarially estimated costs for accidents which occurred on or after July 1, 1990. Premium revenue is no longer used to cover the liability for claims incurred prior to July 1, 1990. As a result, the term "actuarially sound" applies only to the New Fund. To be "actuarially sound" State Fund management must set New Fund premium rates at amounts sufficient to recover present and future costs of all claims to maturity and to meet reasonable expenses of conducting the business of the State Fund.

The estimated claims liability at June 30, 1995, determined by the State Fund's consulting actuary, discounted at 5.75 percent was $395,837,000. This resulted in a New Fund unrestricted surplus of $58 million. During fiscal year 1994-95, State Fund paid New Fund claims and administrative costs of $77 million and $13 million, respectively.

Effective July 1,1993 state law requires "rates must be set at amounts sufficient, when invested, to carry the estimated cost of all claims to maturity, to meet reasonable expenses of conducting the business of the State Fund, and to amass and maintain, by July 1, 2003, a surplus of 25 percent of the annual premium." The fiscal year 1994-95 annual premium was $152,838,969. The unrestricted surplus of $58 million at fiscal year-end, after actuarial adjustments to estimates for prior accident years of $36.7 million represents 37.9 percent of the annual premium.

Financing Past Claims Liability

The liability and payment of workers' compensation claims for incidents occurring before July 1, 1990 are reported in the Old Fund. At June 30, 1995, the State Fund's consulting actuary valued the remaining liability associated with the Old Fund at an undiscounted amount of $295,749,000. During fiscal year 1994-95, State Fund paid Old Fund claims and administrative costs of $23 million and $3 million, respectively.

The Board of Investments of the state of Montana issued $142,095,000 and $32,500,000 of bonds in July 1991 and October

1993, respectively, for the purpose of funding the state's liability and costs in administering and paying claims related to the Old Fund. Funding for bond and claims payments is provided by old fund liability taxes (OFLT) imposed on employers' payroll (0.5 percent), employees' wages (0.2 percent), and sole proprietors and subchapter S shareholders' distributive income (0.2 percent). On July 24, 1995, the State Fund applied $21 million of surplus payroll tax collections that had accumulated in the Old Fund to defease $20.9 million of the Series 1991 Payroll Tax Bonds.

Prior Audit Recommendations

Prior Audit Recommendations

Our prior report for the fiscal year ended June 30, 1994 included the status of three partially implemented recommendations noted from a prior audit related to claim management. As part of our audit, we reviewed the implementation status of these recommendations. The State Fund implemented one and is in the process of implementing two. The two recommendations partially implemented are discussed below.

Case reserving - In a prior audit report, we recommended the State Fund implement procedures to ensure its claim department established case reserves in a timely manner after receipt of a claim. The State Fund purchased an automated case reserving system and is currently implementing the prior recommendation. In May 1995, the State Fund went on-line with its new case reserving system. Micro Insurance Reserving Analysis (MIRA), the automated case reserving system, has resulted in significant improvement in the level of case reserve adequacy. Case reserve adequacy for the new and old funds improved approximately 28 percent and 15 percent, respectively. The system is currently being utilized by claim adjusters on new and old fund claims. Adjustments are being made to the State Fund's database to improve the accuracy of the data points utilized by the MIRA system. In addition, system adjustments are being made to reflect recent legislative changes effecting workers' compensation benefit levels.

Claim policies and procedures - In a prior audit report, we recommended the State Fund provide documented performance evaluations to all claim personnel. State Fund claim supervisors are currently receiving performance evaluations. Other claim staff are receiving training on the performance evaluation process. Mid-term reviews for all State Fund personnel will begin in January 1996 and annual evaluations in August 1996.

At the request of the Legislative Audit Division, Ernst and Young (E&Y) performed an analysis to determine whether or not the rates of the State Fund effective July 1, 1993, are excessive, inadequate or discriminatory. E&Y published a report, dated July 5, 1994 which contained nine recommendations to improve the rate setting process.

We reviewed the implementation status of these recommendations during our audit. The State Fund has implemented eight of these recommendations and partially implemented one. The recommendation partially implemented relates to adopting a consistent

case reserving process. The status of this recommendation is addressed above under case reserving.

Since the State Fund is in the process of implementing these recommendations we make no further recommendations in these areas at this time.

Findings and Recommendations

Compliance with State Law

State law requires state agencies to record all financial activity on the state's accounting records by fiscal year-end in accordance with generally accepted accounting principles. We reviewed State Fund's compliance with this state law and found areas where improvements could be made. The following paragraphs discuss these areas.

-- Activity recorded within the same accounting entity should be eliminated before fiscal year-end. State Fund did not eliminate intrafund activity amounting to $5.5 million for the New Fund and $270,000 for the Old Fund before fiscal year-end 1994-95 as required by generally accepted accounting principles. As a result, assets and liabilities are overstated on the state's accounting records. State Fund personnel made this adjustment to the financial statements.

-- The State Fund transfers to the Department of Labor and Industry funds for the administrative costs related to enforcement and regulation of the worker's compensation coverage in Montana. State Fund transfers its building bond payment to the Department of Administration. These transactions are recorded on the State Fund's accounting records as transfers out. Generally accepted accounting principles define operating expenses as those recurring costs associated with the central operations of the business. Since the State Fund operates like a business, these transactions are operating expenses not transfers out. Operating expenses are understated and transfers out are overstated by $494,000 and $2.1 million in the Old Fund and New Fund, respectively, in fiscal year 1994-95. These transactions do not effect the net income of the State Fund.

Recommendation #1

We recommend the State Fund record intrafund eliminations and classify expenditures on the accounting records in accordance with generally accepted accounting principles.

Administrative Expense Allocation to the Old Fund

State law requires the State Fund to determine and account for administrative expenditures and benefit payments for accidents occurring prior to July 1, 1990 (Old Fund), separately from accidents after that date (New Fund). The law also limits annual administrative costs of claims associated with the Old Fund to $3 million. As a result of this limit some of the Old Fund administrative expenditures from July 1, 1990 to June 30, 1993 were paid by the New Fund.

Starting in fiscal year 1993-94 State Fund reimbursed the New Fund for Old Fund prior years administrative expenditures up to the $3 million limit. The following table shows the excess administrative expenditures and the amounts to be reimbursed to the New Fund. At fiscal year-end 1994-95 the total of prior years administrative expenditures yet to be reimbursed to future years is $2.8 million. We determined the State Fund procedures reasonably allocated administrative expenditures between the Old Fund and New Fund. This data is presented as informational and we make no recommendations.

Table 1

Old Fund Administrative Expenditures
(in thousands)

	FY 91	FY 92	FY 93	Totals
Amount to be Reimbursed to New Fund	$2,259	$1,280	$647	$4,186
Amount reimbursed	891		443	1,334
Balance to be Reimbursed	1,368	1,280	204	2,852

Source: Compiled by the Legislative Audit Division from State Fund Records.

Independent Auditor's Report & Agency Financial Schedules

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying financial statements of the State Compensation Insurance Fund, a component unit of the State of Montana, as of June 30, 1995 and 1994, and for the two fiscal years then ended, as listed in the table of contents. The information contained in these financial statements is the responsibility of State Compensation Insurance Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State Compensation Insurance Fund, as of June 30, 1995 and 1994, and the results of its operations and of its cash flows for the fiscal years then ended in conformity with generally accepted accounting principles.

Respectfully submitted,

James Gillett

James Gillett, CPA
Deputy Legislative Auditor

September 22, 1995

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STATE COMPENSATION INSURANCE FUND
(a component unit of the State of Montana)
BALANCE SHEET (with comparison to prior fiscal year end)

NEW FUND

(Thousands of Dollars)

ASSETS	As Of June 30, 1995	As Of June 30, 1994
Cash in Treasury	$2,252	$2,520
Short-term Investment Pool (Note 1)	38,515	36,803
Premium Receivable (Note 1)	19,478	56,255
Allowance for Doubtful Accounts	(521)	(801)
Due from Other Funds	2,054	1,351
Interest Receivable	5,508	3,267
Short-term Notes & Loans Receivable	102	515
Long Term Securities (Note 2)	418,542	310,236
Supplies Inventory	73	34
Equipment	3,233	2,362
Less Accumulated Depreciation	(1,082)	(724)
Intangible Assets	1,472	19
Property Held in Trust	1,360	8,546
Other Assets	262	8
Total Assets	$491,248	$420,391

LIABILITIES AND FUND EQUITY

Liabilities		
Estimated Claims Liability (Note 4)	$395,837	$373,223
Unearned Premium	21,748	24,089
Security Deposits	1,835	15,807
Accounts Payable	579	105
Due to Other Funds	1,002	374
Compensated Absences (Note 8)	650	568
Total Liabilities	$421,651	$414,166
Fund Equity		
Contributed Capital	$11,584	$12,000
Unrestricted	58,013	(5,775)
Total Fund Equity	$69,597	$6,225
Total Liabilities and Fund Equity	$491,248	$420,391

The notes are an integral part of the financial statements.

STATE COMPENSATION INSURANCE FUND
(a component unit of the State of Montana)
STATEMENT OF OPERATIONS
AND CHANGES IN FUND EQUITY (with comparison to prior fiscal year end)

NEW FUND	*(Thousands of Dollars)* Fiscal Year Ending June 30, 1995	Fiscal Year Ending June 30, 1994
UNDERWRITING RESULTS		
Premium	$153,712	$182,489
Less: Reinsurance Premium Paid and Safety Incentives	(873)	(863)
Claims Expenses:		
Compensation Benefits	46,242	45,473
Medical Benefits	31,087	30,087
Allocated Loss Adjustment Expenses	396	214
Increase in Estimated Claims Liability	22,614	76,678
Other Expenses:		
Operating Expenses	10,808	9,090
Transfers Out	2,102	2,401
Underwriting Gain/(Loss)	$39,590	$17,683
Investment Income	$23,963	$13,986
Other Income	240	180
RESULTS OF OPERATIONS	$63,793	$31,849
Gain/(Loss) on Sale of Fixed Assets	(5)	3
NET INCOME (LOSS)	$63,788	$31,852
PRIOR YEAR END UNRESTRICTED EQUITY	($5,775)	(37,627)
END of PERIOD UNRESTRICTED EQUITY	$58,013	($5,775)

The notes are an integral part of the financial statements.

STATE COMPENSATION INSURANCE FUND
(a component unit of the State of Montana)
STATEMENT OF CASH FLOWS (with comparison to prior fiscal year end)

NEW FUND	*(Thousands of Dollars)* Fiscal Year Ending June 30, 1995	Fiscal Year Ending June 30, 1994
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts for Premiums	$181,282	$188,824
Payments to Suppliers for Goods and Services	(6,131)	(3,307)
Payments to Employees	(6,371)	(5,508)
Cash Payments for Claims	(77,399)	(75,574)
Other Operating Revenues	210	53
Net Cash Provided by (Used for) Operating Activities	**$91,591**	**$104,488**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Transfers to Primary Government	$0	($3,547)
Cash Payments for Loans		(28,266)
Collection for Principal and Interest on Loans	0	43,173
Net Cash Provided by (Used for) Noncapital Financing Activities	**$0**	**$11,360**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition of Fixed Assets	($3,397)	($975)
Proceeds from Sale of Fixed Assets	429	3
Net Cash Used for Capital and Related Financing Activities	**($2,968)**	**($972)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of Investments	($231,745)	($274,884)
Proceeds from Sales or Maturities of Investments	122,210	146,612
Interest and Dividends on Investments	22,356	13,411
Net Cash Provided by (Used For) Investing Activities	**($87,179)**	**($114,861)**
Net Increase (Decrease) in Cash and Cash Equivalents	**$1,444**	**$15**
Cash and Cash Equivalents, July 1	**$39,323**	**$39,308**
Cash and Cash Equivalents, June 30	**$40,767**	**$39,323**

The notes are an integral part of the financial statements.

STATE COMPENSATION INSURANCE FUND
(a component unit of the State of Montana)
STATEMENT OF CASH FLOWS (with comparison to prior fiscal year end)

RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES

NEW FUND	*(Thousands of Dollars)* Fiscal Year Ending June 30, 1995	Fiscal Year Ending June 30, 1994
Results of Operations	$63,793	$31,849
Adjustments to Reconcile Operating Income to Net Cash Provided by (Used for) Operating Activities:		
Depreciation	372	257
Amortization	262	9
Interest Expense		1
Interest on Investments	(23,963)	(14,081)
Change in Assets and Liabilities:		
Decr (Incr) in Accounts Receivable	37,643	(16,293)
Decr (Incr) in Due From Other Funds	(1,146)	3,458
Decr (Incr) in Inventories	(39)	34
Decr (Incr) in Other Assets	6,929	3,332
Incr (Decr) in Accounts Payable	586	26
Incr (Decr) in Due to Other Funds	1,143	279
Incr (Decr) in Due to Primary Government	(371)	
Incr (Decr) in Deferred Revenue	(2,342)	24,089
Incr (Decr) in Property Held in Trust	(13,973)	(5,237)
Incr (Decr) in Estimated Claims	22,614	76,678
Incr (Decr) in Compensated Absences	83	87
Total adjustments	$27,798	$72,639
Net cash provided by (Used for) Operating Activities	**$91,591**	**$104,488**

The notes are an integral part of the financial statements.

STATE COMPENSATION INSURANCE FUND
(a component unit of the State of Montana)
BALANCE SHEET (with comparison to prior fiscal year end)

OLD FUND

(Thousands of Dollars)

ASSETS	**As Of June 30, 1995**	**As Of June 30, 1994**
Cash in Treasury	$353	$1,404
Short-term Investment Pool (Note 1)	6,634	3,011
Account Receivable (Note 1)	961	987
Allowance for Doubtful Accounts	(370)	(618)
Due from Other Funds (Note 1)	27,426	17,985
Long Term Securities (Note 2)	10,809	10,914
Deferred Bond Issue Costs	3,787	3,939
Other Assets	64	
Total Assets	$49,664	$37,622

LIABILITIES AND FUND EQUITY

Liabilities		
Estimated Claims Liability (Note 4)	$295,749	$339,486
Long Term Bonds Payable (Note 5)	164,829	166,907
Accrued Bond Interest Payable	754	764
Due to Other Funds	2,088	1,792
Arbitrage Rebate Tax Payable	83	34
Other Liabilities	99	31
Total Liabilities	$463,602	$509,014
Fund Equity		
Reserved for Debt Service	$14,169	$14,169
Retained Earnings	(428,107)	(485,561)
Total Fund Equity	($413,938)	($471,392)
Total Liabilities and Fund Equity	$49,664	$37,622

The notes are an integral part of the financial statements.

STATE COMPENSATION INSURANCE FUND
(a component unit of the State of Montana)
STATEMENT OF OPERATIONS
AND CHANGES IN FUND EQUITY (with comparison to prior fiscal year end)

OLD FUND	*(Thousands of Dollars)* **Fiscal Year Ending June 30, 1995**	**Fiscal Year Ending June 30, 1994**
UNDERWRITING RESULTS		
Premium	$926	($5)
Other Income	3	7
Claims Expenses:		
Compensation Benefits Paid	15,972	20,459
Medical Benefits Paid	6,697	7,915
Allocated Loss Adjustment Expenses	194	364
Decrease in Actuarially Estimated Claims	(43,737)	(25,764)
Other Expenses		
Bad Debt Expenses	888	
Administrative Expenses	2,467	1,657
Underwriting Gain/(Loss)	$18,448	($4,629)
Investment Income	$931	$1,253
Interest Expense	(10,653)	(10,332)
Bond Arbitrage Expense	(49)	(34)
RESULTS OF OPERATIONS	$8,677	($13,742)
OTHER SOURCES/(USES) OF FUNDS		
Transfer In-Old Fund Liability Tax Revenue	$48,418	$40,950
Transfer In-Other	1,663	1,219
Transfers Out-Other	(1,304)	(2,382)
Total Other Sources/(Uses) of Funds	$48,777	$39,787
NET INCOME	$57,454	$26,045
PRIOR YEAR END FUND EQUITY	(471,392)	(497,437)
END of PERIOD FUND EQUITY	($413,938)	($471,392)

The notes are an integral part of the financial statements.

STATE COMPENSATION INSURANCE FUND
(a component unit of the State of Montana)
STATEMENT OF CASH FLOWS (with comparison to prior fiscal year end)

OLD FUND	(Thousands of Dollars) Fiscal Year Ending June 30, 1995	Fiscal Year Ending June 30, 1994
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts for Premiums	$71	$7
Payments to Suppliers for Goods and Services	(937)	(604)
Payments to Employees	(1,002)	(1,265)
Cash Payments for Claims	(22,626)	(28,414)
Collections of Notes Receivable	(26)	2
Other operating revenues	4	
Net Cash Provided by (Used for) Operating Activities	**($24,516)**	**($30,274)**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Payment of Principal and Interest on Bonds and Notes	($12,662)	($33,305)
Proceeds from Issuance of Bonds and Notes		40,500
Payment of Bond Issuance Costs		(364)
Transfers to Primary Government	(1,942)	(1,286)
Transfers from Primary Government	40,789	27,167
Net Cash Provided by (Used for) Noncapital Financing Activities	**$26,185**	**$32,712**
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of Investments	($1,091)	($15,918)
Proceeds from Sales or Maturities of Investments	1,032	15,641
Interest and Dividends on Investments	962	1,481
Net cash Provided by (Used for) Investment Activities	**$903**	**$1,204**
Net Increase (Decrease) in Cash and Cash Equivalents	**$2,572**	**$3,642**
Cash and Cash Equivalents, July 1	**$4,415**	**$773**
Cash and Cash Equivalents, June 30	**$6,987**	**$4,415**

The notes are an integral part of the financial statements.

STATE COMPENSATION INSURANCE FUND
(a component unit of the State of Montana)
STATEMENT OF CASH FLOWS (with comparison to prior fiscal year end)

RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES

	(Thousands of Dollars)	
OLD FUND	**Fiscal Year Ending June 30, 1995**	**Fiscal Year Ending June 30, 1994**
Results of Operations	$8,677	($13,742)
Adjustments to Reconcile Operating Income to Net Cash Provided by (Used for) Operating Activities:		
Interest Expense	10,653	10,403
Interest on Investments	(931)	(1,253)
Arbitrage Rebate Tax	49	
Change in Assets and Liabilities:		
Decr (Incr) in Accounts Receivable	(198)	I
Decr (Incr) in Due From Other Funds	66	
Decr (Incr) in Other Assets	(64)	
Incr (Decr) in Accounts Payable	43	
Incr (Decr) in Due to Other Funds	901	16
Incr (Decr) in Due to Primary Government		
Incr (Decr) in Estimated Claims	(43,737)	(25,764)
Incr (Decr) in Arbitrage Rebate Tax Pyable		34
Incr (Decr) in Compensated Absences Payable	25	31
Total adjustments	($33,193)	($16,532)
Net cash provided by (Used for) Operating Activities	**($24,516)**	**($30,274)**

The notes are an integral part of the financial statements.

State Compensation Insurance Fund

(A Component Unit of the State of Montana)

Notes to Financial Statements
for the Two Fiscal Years Ended June 30, 1995

1. Summary of Significant Accounting Policies

Description of Business

The State Compensation Insurance Fund (State Fund) is a nonprofit, independent public corporation established under Title 39, Chapter 71 of the Montana Codes Annotated (MCA). The State Fund provides Montana employers with an option for workers' compensation and occupational disease insurance and guarantees the availability of coverage for all employees in Montana.

The State Fund is governed by a five member Board of Directors appointed by the Governor and is attached to the State of Montana, Department of Administration for administrative purposes only.

During the 1990 Montana Special Legislative Session, legislation passed establishing separate funding and accounts for claims of injuries resulting from accidents occurring before July 1, 1990, referred to as the Old Fund, and claims occurring on or after July 1, 1990, referred to as the New Fund.

The New Fund functions as an autonomous insurance fund supported solely from its own revenues. All assets, debts, and obligations of the New Fund are separate and distinct from assets, debts, and obligations of the State of Montana. Upon dissolution of the New Fund, any monies not needed to liquidate the New Fund would be returned to its policyholders. The State Fund administers the claims remaining in the Old Fund for the State of Montana and is the administering entity for recording the financial activity related to receipt and disbursement of an Old Fund Liability Tax (see note 4, Old Fund). No State general fund money is used for State Fund operations.

The State Fund records activity related to its workers' compensation insurance operations in the Enterprise Fund type. The Enterprise Funds of the State Fund are part of, but do not comprise, the entire Enterprise Fund of the State of Montana. The financial statements in this report reflect the financial position and results of operations and cash flows of the State Fund (New Fund and Old Fund), not the State of Montana.

Because of the Governor's appointment of the board members and the state's regulatory oversight function, the State Fund financial statements are presented as a component unit in the State of Montana Comprehensive Annual Financial Report.

Basis of Accounting
The State Fund uses the accrual basis of accounting, as defined by generally accepted accounting principles, for its workers' compensation insurance operations.

Under the accrual basis, the State Fund records revenues in the accounting period earned, if measurable, and records expenses in the period incurred, if measurable.

<u>Cash and Short Term Investment Pool</u>
Cash balances include demand deposits with the State Treasury. The State Fund also participates in the Montana Board of Investments Short Term Investment Pool (STIP). STIP balances are highly liquid investments with maturities of three months or less. The market value of STIP amounts approximate cost. The New Fund STIP balance of $38,514,782 as of June 30, 1995 represents 4.5% of the total Board of Investment Short Term Investment Pool. The Old Fund STIP balance of $6,633,717 as of June 30, 1995 represents 0.8% of the total Board of Investment Short Term Investment Pool. The New Fund STIP balance of approximately $36,803,000 as of June 30, 1994 represented 4.3% of the total Board of Investment Short Term Investment Pool. The Old Fund STIP balance of approximately $3,011,000 as of June 30, 1994 represented 0.3% of the total Board of Investment Short Term Investment Pool.

The STIP investments' credit risk is measured by investment grade ratings given individual securities. Board of Investment's policy requires that STIP investments have the highest rating in the short term category by one and/or any Nationally Recognized Statistical Rating Organizations (NRSRO). The six NRSRO's include Standard and Poors, Moody's, Duff and Phelps, Fitch, IBCA and Thompson's Bank Watch.

Asset-backed securities constitute 14.9% of the Board of Investment's total STIP portfolio as of June 30, 1995. Asset-backed securities have less credit risk than do securities not backed by pledged assets, while market risk for asset-backed securities is the same as market risk for similar non asset-backed securities. The asset-backed securities were previously reported in the investment type totals for Commercial Paper, Corporate Obligations or Government Securities as of June 30, 1994.

Variable rate (Floating Rate) securities make up 17.9% of the Board of Investment's total STIP portfolio as of June 30, 1995. While variable rate securities have credit risk identical to similar fixed rate securities, their market risk (income) is more sensitive to interest rate changes. However, the market risk (value/price) may be less volatile than fixed rate securities because their value will usually remain at or near par as a result of their interest rates being periodically reset to maintain a current market yield.

There are no legal risks that the Board of Investments is aware of regarding any STIP investments.

Long Term Securities

The State Fund invests monies with the Montana Board of Investments, including STIP amounts. Securities are stated at cost and adjusted for amortization of any discount or premium. Premiums and discounts are amortized using the straight-line method over the life of the securities.Net unrealized gains or losses on securities are not included in adjustments to retained earnings.

State Fund investments are classified in risk category 1 or risk category 2 under State of Montana standards. Risk category 1 includes investments that are insured or registered and held by the Board of Investments or its agent in the State's name. Investments in risk category 2 are uninsured or unregistered in which the securities are held by the counterpart's trust department or agent in the State's name. Asset-backed securities have less credit risk than do securities not backed by pledged assets, while market risk for asset-backed securities is the same as market risk for similar non asset-backed securities. The asset-backed securities were previously reported in the investment type totals for Commercial Paper, Corporate Obligations or Government Securities as of June 30, 1994.

The Board of Investments lends State Fund securities managed by the Board of Investments. State Street Bank was appointed the Board's custodial bank on December 1, 1993. During the period the securities are on loan, the Board receives a fee and the bank must maintain collateral equal to 102% of the market value of the securities on loan. The Board retains all rights and risks of ownership during the loan period. As of June 30, 1995, investments in the New Fund and the Old Fund include $124,636,779 (approximately 30% of total long term securities), and $10,809,018 (approximately 100% of long term securities), respectively, in long term securities on loan which earned interest income of $222,478 and $14,263, respectively. As of June 30, 1994, the New Fund and Old Fund investments included $81,505,623 (approximately 26% of total long term securities), and $10,913,940 (approximately 100% of long term securities), respectively, in long term securities on loan which earned interest income of $50,082 and $5,939, respectively. Securities on loan are classified as risk category 2. All other securities are in risk category 1 (see note 2).

Montana's Constitution does not currently allow the State Fund to invest in equity securities. During the 1995 legislative session, approval was given for an initiative to appear on the November 1996 general election ballot which, if approved, would allow the State Fund to invest in equity securities.

Receivables

The New Fund premium receivable balance of $19.4 million includes $6.8 million of premium due from insureds for insurance coverage provided during fiscal year 1994-1995 not yet received. The remaining $12.6 million represents advanced premiums billed but not received for insurance coverage effective July 1, 1995 as part of the State Fund's Premium in Advance program. This amount is offset in unearned premiums. Estimated uncollectible receivables are reported as an allowance for doubtful accounts of $521,000. Other receivables include $5.5 million in investment income due, and $1.7 million due from the Old Fund in administrative cost reimbursement.

Accounts receivable in the Old Fund include interest receivable and amounts due from past premiums in dispute or in collection. Estimated uncollectible receivables are reported as an allowance for doubtful accounts. Amounts due from other funds represents amounts from Old Fund Liability Tax collections due from the State Special Revenue Account.

Fixed Assets

Equipment is valued at actual or estimated historical cost. Depreciation expense is computed on a straight-line basis for equipment over a period of 5 to 10 years. All fixed assets are recorded in the New Fund. Because the State Fund administers the Old Fund, the Old Fund does not carry fixed assets. The increase in fixed assets of $1.9 million during the year ended June 30, 1995 is primarily from investment in the Benefit Information System for claims management.

Advanced Deposits

Security deposits are deposits by certain policyholders which secure payment of premiums. Unearned premiums reflect amounts in advance that are received or billed, but not yet earned for policies effective July 1, 1995 or July 1, 1994.

Premiums

Premium rates are approved by the State Fund Board of Directors. Policies are effective July 1 through June 30 of each year. Revenue from premiums is recognized over the term of the year.

Policyholders are contractually obligated to pay certain premiums to the State Fund in advance of the period the premiums are earned. Premium advances are refundable when the policyholder's coverage is cancelled and all earned premiums have been credited by the State Fund.

Contributed Capital

Contributed capital includes assets transferred at the inception of the New Fund to provide the initial capitalization, as authorized by state law, and equipment transferred from the Department of Labor and Industry when premium audit functions were transferred to the State Fund.

The reduction in contributed capital is attributable to the disposal of $416,020 worth of outdated computer equipment and other assets which were part of the original New Fund contributed capital.

Fund Equity

Fund Equity consists of contributed capital and the net excess or deficit of assets over liabilities.

Presentation
The financial statements are presented in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board. State Fund insurance operations are classified as an Enterprise Fund, Proprietary Fund type.

The Enterprise Fund type is used to account for operations: (a) financed and operated in a manner similar to private business enterprises, where the legislature intends that the entity finance or recover costs primarily through user charges; or (b) where the legislature has decided that periodic determination of revenues earned, expenses incurred, or net income is appropriate.

The Statement of Operations and Changes in Fund Equity and the Statement of Cash Flow for the fiscal year ended June 30, 1994 have been reclassified from the previous years presentation in order to be comparable with the statements for the fiscal year ended June 30, 1995. There is no impact to net income and cash equivalents as a result of this reclassification.

2. Investments

The amortized cost and market value of the New Fund fixed maturity securities as of June 30, 1995, and June 30, 1994, are as follows.

June 30, 1995	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value
US Treasury Securities	$130,470,836	$3,984,233	($856,819)	$133,598,250
US Government Agencies and US Government Guaranteed Securities	$72,491,089	$691,698	($836,222)	$72,346,565
Corporate Securities Asset Backed	$20,911,436	$22,714	($189,487)	$20,744,663
Other Corporate Securities	$182,196,216	$4,951,355	($646,848)	$186,500,723
Other Securities	$12,472,287	$476,491	$0	$12,948,779
STIP	$38,514,782	$0	$0	$38,514,782
Totals	$457,056,646	$10,126,491	($2,529,376)	$464,653,762

June 30, 1994	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Loss	Market Value
US Treasury Securities	$86,528,114	$33,611	($3,514,325)	$83,047,400
US Government Agencies and US Government Guaranteed Securities	$54,747,259	$78,783	($2,132,981)	$52,693,061
Corporate Securities	$160,934,910	$92,105	($4,233,955)	$156,793,060
Other Securities	$8,026,264	$0	($512,133)	$7,514,131
STIP	$36,802,900	$0	$0	$36,802,900
Totals	347,039,447	$204,499	($10,393,394)	$336,850,552

The amortized cost and estimated market value of fixed maturity securities as of June 30, 1995, are shown below at contractual maturity. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Estimated Market Value
Due one year or less	$39,014,782	$39,013,242
Due after one year through five years	$225,419,942	$228,474,692
Due after five years through ten years	$94,048,998	96,068,384
Due after ten years	$98,572,924	101,097,444
Totals	$457,056,646	$464,653,762

During fiscal year ending June 30, 1995, the New Fund realized gross gains from sales of securities of $600,732 and gross realized losses were $1,884,963. During fiscal year ending June 30, 1995, the Old Fund realized gross gains from sales of securities of $18,251 and no realized gross losses. During fiscal year ending June 30, 1994, the New Fund had gross realized gains of $949,786 and gross realized losses of $786,519. The Old Fund realized gross gains from the sales of securities of $474,899 and had no realized losses during the fiscal year ending June 30, 1994.

Long term securities in the Old Fund of $10,809,018 at June 30, 1995 and $10,913,990 at June 30, 1994 are required debt service reserve deposits related to long term workers' compensation program bonds. The market value of these securities was $10,631,460 and $10,416,515 at June 30, 1995 and June 30, 1994, respectively. Old Fund STIP balance at June 30, 1995 and June 30, 1994, include $2.6 million and $2.8 million, respectively, in required debt service reserve deposits for variable rate payroll tax bonds (see note 5).

3. Reinsurance

The State Fund cedes reinsurance to other insurance companies to limit the exposure arising from large losses. These arrangements consist of excess of loss contracts which protect against losses over stipulated amounts. During the fiscal year ending June 30, 1995, the State Fund retained the first $1.25 million of each loss and $1.8 million in aggregate retention, while reinsurers were liable for losses in excess of $1.25 million up to a limit of $50 million on occurrences involving multiple claimants. Individual, per person coverage was provided up to $2 million per claimant. During the fiscal year ending June 30, 1994, the State Fund retained the first $1 million of each loss and $1.6 million in aggregate retention, while reinsurers were liable for losses in excess of $1 million up to a limit of $20 million on occurrences involving multiple claimants. Individual per person coverage was provided up to $2 million per claimant. In the event reinsurers are unable to meet their obligations, the State Fund would remain liable for all losses as the reinsurance agreements do not discharge the State Fund from its primary liability to the policyholders. Premium revenue is reduced by premiums paid for reinsurance coverage of $268,558 and $318,356 in fiscal years 1994-95 and 1993-94, respectively.

Reinsurance had no effect on fiscal year 1994-95 losses and loss adjustment expense.

4. Risk Management/Public Entity Risk Pools

The Old and New Funds are public entity risk pools. Neither fund had significant reductions in insurance coverage from the prior year, nor any insurance settlements exceeding insurance coverage. Unpaid claims and claim adjustment expenses are estimated based on the ultimate cost of settling the claims, including the effects of inflation and other socioeconomic factors.

New Fund—liability coverage to employers for injured employees that are insured under the Workers' Compensation and Occupational Disease Acts of Montana and workers' compensation claims occurring on or after July 1, 1990, are reported in the New Fund. The New Fund must insure any employer who desires coverage. At June 30, 1995, approximately 25,607 employers were insured with the New Fund. At fiscal year-end 1993-94, approximately 26,100 employers were insured by the New Fund. Anticipated investment income is considered for computing premium rate levels and employers must pay premiums to the State Fund within specified time frames.

Tillinghast, a Towers Perrin company, prepared an actuarial study and estimated liabilities and the ultimate cost of settling claims reported but not settled and claims incurred but not reported for the New Fund as of June 30, 1995 and June 30, 1994. Because actual claim costs depend on such complex factors as inflation and changes in the law, claim liabilities are recomputed periodically using a variety of actuarial and statistical techniques to produce current estimates that reflect recent settlements, claim frequency, and other economic and social factors.

A provision for inflation and the calculation of estimated future claim costs is implicit in the calculation because reliance is placed both on actual historical data that reflect past inflation and on other factors that are considered to be appropriate modifiers of past experience. As of June 30, 1995, $541,373,699 of unpaid claims and claim adjustment expenses are presented at their net present value of $395,837,222. These claims are discounted at an annual rate of 5.75%. As of June 30, 1994, $509,019,962 of unpaid claims and claim adjustment expenses are presented at their net present value of $373,223,095, discounted at an annual rate of 5.75%. When the New Fund purchases annuity contracts, the claim is settled in full and on a final basis, and all liability of the New Fund is terminated.

State law requires the New Fund to set premiums at least annually at a level sufficient to ensure adequate funding of the insurance program during the period the rates will be in effect. State law also requires the State Fund to establish a minimum surplus balance of 25% of annual premium revenue.

Old Fund—the liability and payment of workers' compensation claims for incidents occurring before July 1, 1990, are reported in the Old Fund. There is no premium income; however, funding for claims payments is provided by Old Fund Liability Taxes (OFLT) imposed on employer payroll (0.5%), employee wages (0.2%), and sole proprietor and subchapter S shareholder distributive income (0.2%). The OFLT provides funding for Old Fund claim expenses and Old Fund bond payments (see note 5). An actuarial study prepared by Tillinghast, a Towers Perrin company, for the Old Fund as of June 30, 1995, was used to estimate liabilities and the ultimate cost of settling claims that have been reported, but not settled and claims that have been incurred, but not reported. As of June 30, 1995, $295,748,844 of unpaid claims and claim adjustment expenses are presented at face value. As of June 30, 1994, $339,485,647 of unpaid claims and claim adjustment expenses are presented at face value. Total Old Fund deficit as of June 30, 1995 is $413,937,723 compared to a deficit of $471,393,590 as of June 30, 1994. This fund does not discount estimated claims liability.

Changes in Claims Liabilities for the Past Two Years

The following table presents changes (in thousands) in the aggregate liabilities for the New Fund and the Old Fund for the past two years. The information presented has not been discounted.

	New Fund		Old Fund	
	1995	1994	1995	1994
Unpaid claims and claim adjustment expenses at beginning of year	$509,020	$404,706	$339,485	$365,249
Incurred claims and claim adjustment expenses:				
Provision for insured events of the current year	173,327	184,039		
Increases (decreases) in provision for insured events of prior years	(63,249)	(3,952)	(3,795)	2,975
Total incurred claims and claim adjustment expenses	110,078	180,087	(3,795)	2,975
Payments:				
Claims and claim adjustment expenses attributable to insured events of the current year	(18,137)	(18,693)		
Claims and claim adjustment expenses attributable to insured events of prior years	(59,587)	(57,080)	(39,942)	(28,739)
Total Payment	**(77,724)**	**(75,773)**	**(39,942)**	**(28,739)**
Total unpaid claims and claim adjustment expenses at end of the year	**$541,374**	**$509,020**	**$295,749**	**$339,485**

Risk Management Trend Information

The following table illustrates how the earned revenues of the New Fund plus investment income compare to related costs of loss and other expenses assumed by the State Fund for fiscal years 1991 through 1995. In addition, cumulative amounts related to estimated and actual paid claims are presented. The information allows for comparison of actual and estimated claims and is a basis for developing revenue and claims information. As data for individual policy years mature, the correlation between original estimates and reestimated amounts is used to evaluate the accuracy of incurred claims currently recognized for less mature policy years.

	New Fund				
	1991	1992	1993	1994	1995
1. Net earned required contribution and investment revenues	$113,734	$144,035	$181,715	$191,794	$156,782
2. Unallocated expenses including overhead	6,048	8,232	9,325	9,090	11,303
3. Estimated ultimate incurred claims and expenses:					
End of policy year	137,237	183,425	186,480	199,890	164,824
4. Paid (cumulative) as of:					
End of policy year	17,618	20,244	18,347	18,693	18,137
One year later	44,335	50,576	46,343	45,947	
Two years later	64,079	68,837	62,717		
Three years later	74,901	77,950			
Four years later	81,747				
5. Reestimated ultimate incurred claims and expense:					
End of policy year	$137,237	$183,425	$186,480	$199,890	$164,824
One year later	166,980	184,968	184,030	176,979	
Two years later	160,272	175,218	161,045		
Three years later	151,554	156,660			
Four years later	138,180				
6. Increase (decrease) in estimated incurred claims and expense from end of policy year	943	(26,765)	(25,435)	(22,911)	

5. Payroll Tax Bonds (Workers' Compensation Program)

The Montana Board of Investments issued $142,095,000 of bonds in July 1991, for the purpose of funding the state's liability and costs in administering and paying claims for injuries resulting from accidents, prior to July 1, 1990, that are subject to the Montana Workers' Compensation Act and the Occupational Disease Act of Montana. The bonds bear interest at rates from 4.9% to 6.875% and are limited obligations of the State of Montana, payable solely from and secured by certain Old Fund liability tax revenues collected by the Montana Department of Revenue. Amounts of bond debt outstanding as of June 30, 1995 are shown below (in thousands).

Bonds Outstanding June 30, 1995	Discount	Net Bond Debt June 30,1995
$134,115	$1,786	$132,329

Debt service requirements for principal and interest are as follows (in thousands):

Fiscal Year	Debt Service Payments
1995-96	$11,321
1996-97	11,318
1997-98	11,318
1998-99	11,318
1999-2000	11,320
2000+	226,402
Totals	**$282,997**

On October 27, 1993, the Board of Investments issued $32,500,000 in Variable Rate Payroll Tax Bonds (Workers' Compensation Program Series 1993) to pay the costs associated with claims incurred on or before June 30, 1990. The Series 1993 Bonds are limited obligations of the State of Montana, payable solely from and secured by certain Old Fund liability tax revenues. Bond proceeds were used to repay $21,321,007 in loan principal and interest to the New Fund and the remaining proceeds, after issuance costs, of $7,962,247 were pledged to meet Old Fund claims costs. The variable rate bonds pay interest determined on a weekly period established by a remarketing agent. The variable rate bonds are subject to redemption at the discretion of the Board of Investments during the period variable rates are applied on the bonds. The bonds are payable June 1, 2020, unless terminated at an earlier date upon certain occurrences. In fiscal year 1994-95, $1,285,004 in interest payments and fees were paid on the variable rate bonds. Interest and fees paid during fiscal year 1993-94 on the variable rate bonds was $601,827.

6. Administrative Cost Allocation

State law requires the State Fund to separately determine and account for administrative expenses and benefit payments for claims for injuries resulting from accidents occurring before July 1, 1990 (Old Fund) from those occurring on or after July 1, 1990 (New Fund). The law also limits annual administrative costs of claims associated with the Old Fund to $3 million. The State Fund allocated $3 million and $2.9 million in administration costs to the Old Fund in fiscal years 1994-95 and 1993-94, respectively. The Old Fund has a $2.8 million obligation to the New Fund in unrecovered administrative costs in previous years. The New Fund intends to recover this amount in future years where the cost of administering the Old Fund is less than the statutorily permitted $3 million.

7. Transfers

Operating transfers out of the New Fund include transfers to the Department of Labor and Industry for regulatory administrative assessments charged to the State Fund.

Operating transfers recorded in the Old Fund include $48.4 million in fiscal year 1994-95 and $40.9 million in fiscal year 1993-94 of Old Fund Liability Tax (OFLT) revenue collected by the Montana Department of Revenue (see note 4, Old Fund) and recorded in the State Special Revenue Fund. Included in the administrative costs of the Old Fund are operating transfers out of $494,633 for fiscal year 1994-1995, and $1.3 million for fiscal year 1993-94. The remaining balance in these transfers are for amounts transferred from the Old Fund bond accounts into the Old Fund State Special Revenue account and then to the Old Fund claim account for amounts not required to pay bond debt.

8. Compensated Absences

Employees at the State Fund accumulate both annual and sick leave. The State Fund pays employees for 100% of unused annual leave and 25% of unused sick leave upon termination. The fund pays 100% of unused compensatory leave credits upon termination to nonexempt employees. The State Fund absorbs expenditures for termination pay in its annual operational costs. The State Fund had a total leave liability of $705,292 and $598,092 at June 30, 1995, and June 30, 1994, respectively.

9. Pension Plan

The State Fund and its employees contribute to the Public Employees Retirement System (PERS), a cost sharing, multiple employer, defined benefit pension plan. Established in 1945 and governed by Title 19, Chapter 3, MCA, PERS participants are eligible to retire at age 60 with at least five years of service, at age 65 regardless of length of service or at 30 years of service regardless of age. A reduced retirement benefit may be taken with 25 years of service or at age 50 with a minimum of five years of service. Monthly retirement benefits are calculated by taking 1/56 times the years of service times the final average monthly salary. Vesting occurs once membership service totals 5 years. State Fund and its employees each were required to contribute 6.7% and 6.7% of annual compensation in fiscal years 1994-95 and 1993-94, respectively.

As of June 30, 1995, there were 268.75 State Fund full-time equivalents (FTE) covered by PERS. State Fund covered payroll was $6,085,190 and PERS contributions were $394,171 for the fiscal year ended June 30, 1995. As of June 30, 1994, there were 249.75 State Fund full-time equivalents (FTE) covered by PERS. State Fund covered payroll was $5,219,689 and PERS contributions were $434,174 for the fiscal year ended June 30, 1994.

Actuarial valuations are performed at PERS every two years. The latest valuation was performed as of July 1, 1994. In calculating the pension benefit obligation, the actuary assumed a return on investments of 8%, salary inflation increases of 6.25% and no change in post retirement benefits.

The "pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee service to date. The measure, which is the actuarial present value of credited projected benefits, is intended to help users assess the system's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due and make comparisons among employers. The State Fund is unable to determine the actuarial present value of credited projected benefits and net assets available for benefits since the information is available only on a total state basis, not agency basis.

The pension benefit obligation as of June 30, 1995, for PERS as a whole was \$1,591,420,109. The system's net assets available for benefits at cost on June 30, 1995, were \$1,276,855,695 leaving an overall unfunded pension benefit obligation of \$314,564,414. The State Fund's 1995 contribution represented approximately 1 percent of total June 30, 1995, contributions required of all participating entities.

The pension benefit obligation as of June 30, 1994, for PERS as a whole was \$1,475,985,705. The system's net assets available for benefits at cost on June 30, 1994, were \$1,202,063,252 leaving an overall unfunded pension benefit obligation of \$273,922,453. The State Fund's 1994 contribution represented approximately 1.1% of total June 30, 1994, contributions required of all participating entities.

The State Fund is not responsible for any state system unfunded liability.

Ten-year historical trend information showing the PERS progress in accumulating sufficient assets to pay benefits when due is presented in the system's June 30, 1995, annual financial report.

10. Building

The 1981 Legislature appropriated funds for the construction of a Workers' Compensation building. State Fund expenses annual payments on the building in its operating budget. As of July 1, 1990, the State Fund transferred the value of the building from its records to the Department of Administration, which owns most other state buildings and charges agencies rent for their use. Under the agreement, the State Fund will pay all costs associated with the building, including utilities, debt service, property taxes, janitorial services, and maintenance in lieu of paying rent.

11. Contingencies

A class action was filed before the Workers' Compensation Court in *Murer, et al. vs. Montana State Compensation Mutual Insurance Fund, et al.*, which attempts to have the Court rule that a freeze on workers' compensation benefits in place in fiscal years 1988 through 1991 should no longer apply once the date of the freeze has expired. The State Fund's position is that the law in existence at the time of the injury applies for the life of the claim. The case was rejected by the Workers' Compensation Court as a class action and the decision was affirmed by the Montana Supreme Court. The case was then set before the Workers' Compensation Court and included only named claimants and insurers. Though not a class action, an adverse decision will have the same impact. The Workers' Compensation Court rejected the case and it was appealed to the Montana Supreme Court. On November 21, 1994, the Montana Supreme Court reversed the decision of the Workers' Compensation Court. The estimated amount of loss has been previously estimated at amounts up to $1,000,000. Management believes the ruling will impact both the New Fund and the Old Fund; however, this case is subject to a pending rehearing request before the Montana Supreme Court and then a hearing on remand before the Workers' Compensation Court to rule on issues, so claims eligible for recovery can be fully determined. As a result, an estimate of actual loss incurred cannot be determined until the State Fund receives final decisions on this matter.

12. Subsequent Event - Old Fund Bond Defeasance

On July 24, 1995, the State Fund applied $21,495,949 of OFLT collections that had accumulated in the Old Fund to defease a portion of the Series 1991 Payroll Tax Bonds issued by the State Board of Investments to pay unfunded liabilities of the Old Fund. The State Fund defeased $20,880,000 of the 6.875% term bonds due on June 1, 2020. The funds were deposited by the Board of Investments with an escrow agent and invested in U.S. government non-callable direct obligations which provide for payment of principal and interest through maturity for the defeased bonds. The escrow is irrevocable, but the Board of Investments has retained the right to call the defeased bonds prior to maturity if the value of the escrow is sufficient to do so. The escrow meets the requirements of legal defeasance and the $20,880,000 of 2020 term bonds will be removed from the financial statements of the Old Fund. There will be an accounting loss of $404,612 in the Old Fund in connection with the defeasance. The defeasance resulted in a reduction of debt service to maturity of $56,033,937, and a net savings in interest cost to the State of Montana of $34,294,152.

Agency Response

STATE FUND MONTANA
STATE COMPENSATION INSURANCE FUND
5 SOUTH LAST CHANCE GULCH
P.O. BOX 4759
HELENA, MONTANA 59604-4759
Carl W. Swanson, President
General Information (406) 444-6500
Executive (406) 444-6518

December 4, 1995

Scott A. Seacat
Legislative Auditor
Room 135
State Capitol Building
Helena, MT 59620

Subject: State Compensation Insurance Fund's Financial Compliance Audit for Fiscal Year 1994-95

I would like to thank your staff for their effort and cooperation during this audit. Enclosed is our response to the recommendation made in your 1994-95 audit of the State Compensation Mutual Fund and two copies of the draft report your staff provided to us.

We appreciated having the opportunity to discuss the audit recommendation with your staff, and we look forward to responding to any additonal questions the Legislative Audit Committee may have regarding this audit.

Sincerely,

Carl W. Swanson
President

cc: Rick Hill, Chairman of the Board

Benefits Department 1-800-332-6102 • First Report of Accident 1-800-243-9121 • Underwriting Department 1-800-336-8968
Fraud Hotline 1-800-922-2873 • Loss Prevention/Premium Audit (406) 444-6584 • TDD (406) 444-5971

State Compensation Insurance Fund

Response to Legislative Audit Recommendations

Recommendation #1

We recommend the State Fund record intrafund eliminations and classify expenditures on the accounting records in accordance with generally accepted accounting principles.

Agency Response

We Concur. The State Fund tracks premium income, investment income and claims expenses on SBAS by accident year. During the fiscal year end period, we made adjusting entries to ensure operating accounts were correct by accident year. The adjustments made on SBAS during the fiscal year end period, automatically adjusted assets and liabilities for the intra fund activity resulting in the misstatement. We will review how we code transactions at fiscal year end and ensure this type of problem will not occur.

The second part of the discussion of the recommendation is a classification issue on the uses of funds and does not impact the net income. As far as we can tell, the transfer accounts were used when the State Fund was a division of the Department of Labor and Industry. Now that we are a separate entity, an expenditure classification is more appropriate. The recommendation will require that we work with the Department of Labor and Industry and Department of Public Health and Human Services so that the transfer in they record is adjusted to reflect a revenue source to them. We will make the adjustments so that fiscal year 1995-96 statements are correct.